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Asset Management

Cidel's Global Equity Strategy Commentary

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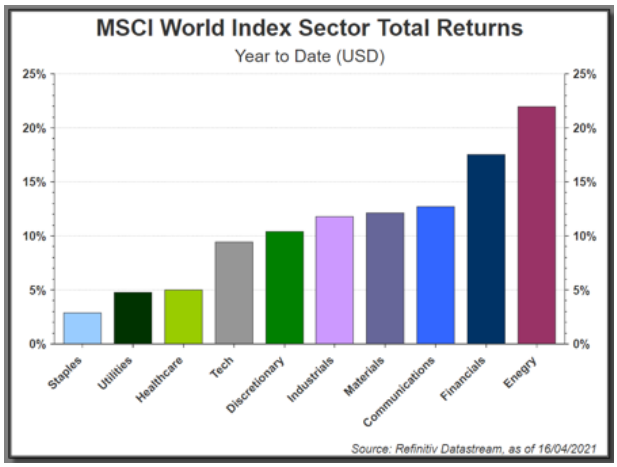
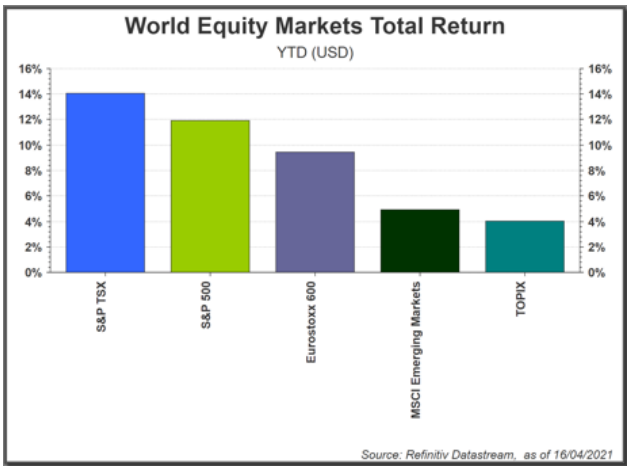
Equities continued the strong run they have been on since last March, as reflected in the MSCI World Index returning 8.3% in USD terms year to date through April 16th. The underlying theme was the anticipation of accelerating economic growth resulting from widespread vaccination campaigns around the world. Similar to the final quarter of 2020, the strongest sectors were those with the most to gain from a better economic environment- more often than not the companies that suffered the brunt of 2020's problems. Energy and Financials were the best performing sectors, while Consumer Staples, Utilities and Healthcare have thus far seen minimal returns as their earnings remained relatively stable last year and are not benefitting from the present dramatic upward estimate revisions that the more cyclical sectors are enjoying. Regardless, these are three of the highest quality sectors – meaning they have consistent profitability and predictable growth – and we believe their recent underperformance is not sustainable. Rising bond yields pressured the valuations accorded to faster growing companies, most notably in the Information Technology sector. This rebound in cyclical sectors has led to a phenomenon that has not been witnessed in quite some time: outperformance by Canadian equities!





However, the outperformance of cyclical sectors barely captures the risk taking and speculation that characterized the start of 2021. A new generation of retail investors entered the stock market and targeted a host of unpopular, heavily shorted stocks, most notably GameStop Corp. Lower account minimums and transaction costs have facilitated a level of single stock volatility that has not been seen since the very height of the tech bubble in the late 1990s. Huge amounts of liquidity provided by central banks around the world have greatly reduced the appeal of holding and earning some meaningful interest on cash. Further, investors choosing to allocate to cash is one of the most natural and obvious curbs to excess speculation. Digital currencies and assets also enjoyed incredible performance. Until the expectation emerges that investors can once again earn a positive real (after inflation) return on cash or other "riskless" assets, this speculative fervor may continue for a good while yet. While increases in short term interest rates do not appear to be on the immediate horizon, it is worth noting that the U.S. 5 Year Treasury yield has risen to over 80 basis points after having been less than 30 basis points in the summer of 2020.

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The 2 Year Treasury is still yielding just a miserable 15 basis points or so; both of these bonds' yields are well below any inflation metric one chooses to examine. However, investors would be well advised to keep an eye on this part of the Treasury curve. If and or when it starts to rise – which would be perfectly understandable given the pickup in inflation numbers and overall growth – the supportive backdrop that has existed for some of the aggressive investing witnessed early in 2021 could be compromised.

In the longer term, it will be interesting to see if the rise of cryptocurrencies and other non-traditional assets leads to an evolution in central banks. Most central banks have dual mandates to maximize employment and keep inflation at a moderate but positive level. A decade of ultra-low interest rates (two decades in the case of Japan) has provided a fertile environment where speculative bubbles can rise potentially to the size where their rupture can spill into the "real" economy so we would not be surprised to see if this mandate is expanded to include managing the risk of these asset bubbles. For example, the most widely held cryptocurrency is now large enough and has enough investors that a sudden price reverse could absolutely lead to a sharp slowdown in economic growth. Residential real estate prices have been another principal non-capital market beneficiary of ultra-low rates. While price increases have been rewarding for long time home owners, the younger generation in many countries are now finding home ownership an elusive dream. Central banks could be under increasing pressure in the coming years to re-examine the costs and benefits of their low interest rate and quantitative easing policies.

The Strategy made a number of changes this quarter. New investments include:

- United Community Banks Inc. is a regional bank in the southeastern U.S. that has an attractive demographic footprint in some of America's fastest growing states. The bank has a strong balance sheet with a very large, low cost deposit base. It has handled the economic downturn of 2020 very well and is well positioned to capitalize on a rebound in consumer, construction and small business loan demand.

- Sandvik AB. is a Swedish industrial company that produces capital goods and parts for a diverse group of industries including mining, automotive, steelmaking and construction. The company is in the strong position of enjoying the improved margin profile from its recent restructuring at the same time as a cyclical recovery in many of its end markets.

- SalMar ASA is a Norwegian salmon farmer with assets in Norway, Scotland and the Faroe islands. Global salmon consumption consistently rises faster than supply, which, over the medium and long term, has led to a favourable pricing dynamic. SalMar is arguably the best operator in the industry, as reflected in its strong balance sheet, and attractive dividend yield coupled with dividend growth prospects.

- Dollar General Corporation is a U.S. retailer with strong store opening growth prospects. The chain has good store growth opening prospects as it expands throughout the U.S and its management has an excellent track record of growing the business. The pandemic has been particularly brutal for many small and independent businesses (including retailers) and chains such as Dollar General will benefit accordingly.

- ConocoPhillips is a largely U.S.-focused oil and gas producer. Following last year's acquisition of American peer, Concho Resources, the company has further added to its strong land position in the lower 48 states that provides for low cost production. The company retains a strong balance sheet and credit rating, an attractive dividend yield and strong prospects for share buybacks should energy prices sustain their recent levels. It is also one of the few North American energy producers to commit to the framework of the Paris climate accord, and is targeting zero net emissions by 2050.

Names that were sold include Alstom SA, Kao Corporation, MapleTree Logistics Trust and the Van Eck Gold Miners ETF. These stocks were chosen as the source of funding for the five aforementioned purchases for a variety of reasons. In the case of Alstom, we believe that, while the Bombardier train acquisition makes long term strategic sense, this may prove to be a difficult business to integrate and fix over the short term; and frankly Sandvik is a better positioned European industrial over the medium term. Kao is facing rising competitive intensity in a few of its key product lines. MapleTree Logistics Trust is nicely positioned, but we fear some of the strong unit price performance of last year may be unwound as interest rates rise. A similar risk exists for the Van Eck Gold Miners ETF.